UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

VIP COMPANION-CARE, INC.	CASE NO. 98-65240
Debtor	Chapter 11

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

Under consideration by the Court are three contested matters in the bankruptcy case of

VIP Companion-Care, Inc. ("Debtor"). On February 24, 1999, The Upstate National Bank, f/k/a First National Bank of Lisbon (the "Bank") filed a motion pursuant to § 362(d)(2) of the Bankruptcy Code (11 U.S.C. §§ 101-1330) (the "Code") seeking relief from the automatic stay in connection with certain collateral in which it asserts a perfected security interest. Opposition to the Bank's motion was filed on behalf of the Debtor on March 3, 1999. The second motion now before the Court was filed on March 15, 1999, by Cecile J. Buck ("C. Buck") and Girdon E. Buck ("G. Buck") (hereinafter jointly referred to as the "Bucks") requesting that the case be converted from chapter 11 to chapter 7.[1] Opposition to the Bucks' motion was filed on behalf of the Debtor on March 30, 1999, and by Arnold Benson ("Benson") on April 1, 1999.[2] The final motion under consideration was filed by way of Order to Show Cause by the Debtor on April 2, 1999, seeking approval of the appointment of a trustee under Code § 1104. An affidavit in opposition to the Debtor's motion was filed on April 8, 1999, by Andrew Buck ("A. Buck"), the Bucks' son who is responsible for the management of the day-do-day finances of the Debtor pursuant to the terms of the November Order.

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[1] According to the Debtor's schedules, the Bucks hold an unsecured claim of $926,000 based on the Debtor's guarantee of a debt of AB Consulting Corporation ("AB Consulting"), a related debtor.

[2] On January 22, 1999, Benson, the former president of the Debtor, filed a motion requesting that the Court vacate its prior order of November 9, 1998 ("November Order") approving a Stipulation whereby C. Buck was retained as the Debtor's President with full operating control of the Debtor, and Benson was retained as Vice President with responsibility for the development of new business contacts and opportunities for the Debtor, as well as for the preparation and filing of a chapter 11 plan. Benson's motion was heard on February 16, 1999, in Syracuse, New York, and adjourned to March 9, 1999. An evidentiary hearing was held on March 26, 1999, and continued to April 1, 1999, April 9, 1999, and April 20, 1999, in Utica, New York. At the conclusion of the evidence on April 20, 1999, the Court ruled from the Bench and denied Benson's motion. The Court signed an Order to that effect on April 28, 1999. Benson has filed a Notice of Appeal from that Order on May 10, 1999.

An evidentiary hearing was commenced on April 9, 1999, in Utica, New York, and concluded on April 20, 1999, at which time the Court reserved its decision on the three contested matters.[3]

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of all of these contested matters pursuant to 28 U.S.C. §§ 1334(b), 157(a), (b)(1), (b)(2)(A), (G) and (O).

FACTS

The Debtor is in the business of providing assistance to individuals with special needs and to the elderly. Services include live-in companions, adult sitter care, convalescent rehabilitative care, meal preparation, etc. In late March or early April 1996, the Debtor entered into an option agreement with AB Consulting, of which Benson is the sole director and shareholder, to acquire the majority of outstanding capital stock of the Debtor, then owned by the Bucks. Under the terms of the agreement, AB Consulting was to manage the Debtor for a period of one year with

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[3] Pursuant to a letter dated April 14, 1999, from the Bank's counsel, the Bank did not participate in the hearing on April 20, 1999, submitting its motion on the evidence presented on April 9, 1999, and the evidence to be presented on April 20th regarding the ability of the Debtor to reorganize. The Court responded in a letter dated April 21, 1999, indicating that "[b]ecause the potential conversion of this case to Chapter 7 would result in the appointment of a trustee who would presumably want to review your client's security interest, it is requested that Upstate Bank waive the 30 day requirement of 11 U.S.C. § 362(e) and allow the Court to consider the §§ 1112(b) and 1104 motions first."

an option to purchase the Debtor at the end of that term. Benson, as president of both the Debtor and AB Consulting, operated the Debtor until approximately July 22, 1998, when David A. Greenwood was appointed receiver ("State Court Receiver") in an action commenced by the Bucks in New York State Supreme Court, Onondaga County, against the Debtor, Benson, and AB Consulting for "collection on promissory notes in connection with the sale of business."[4] *See* ¶ 4 of Debtor's Statement of Financial Affairs. On August 14, 1998, approximately three weeks after the appointment of the State Court Receiver, Benson, as president of the Debtor, filed a voluntary petition under chapter 11 of the Code on behalf of the Debtor.

According to Schedule D, filed by the Debtor on January 29, 1999, the Bank is owed approximately $350,000, secured by "accounts receivable, furniture, equipment, all intangible and tangible assets, and after acquired property, books and records" ("Collateral"). According to the testimony of John J. Patrillo ("Patrillo"), vice president in the collection and lending division of the Bank, there are two outstanding loan obligations owed by the Debtor to it. The first has a balance of $45,354.41. The second loan has a balance of $299,997 and includes not only various advances made to the Debtor, but also includes a personal loan to Benson of $100,000 in connection with the construction of a condominium in the Cayman Islands allegedly

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[4] An evidentiary hearing was conducted on September 25, 1998 ("September 1998 Hearing"), in connection with an Order to Show Cause why the State Court Receiver should not be removed and replaced by Benson. The stipulation approved by the Court in its November Order was entered into by the parties following the September 1998 Hearing. At the hearing on March 26, 1999 ("March 1999 Hearing") held in connection with Benson's motion seeking revocation of the November Order, the Bucks' attorney requested that the Court consider all the testimony and exhibits of the September 1998 Hearing on the basis that the March 1999 Hearing was merely a continuation of the September 1998 Hearing. The Court deems it appropriate to incorporate some of the background facts elicited at the September 1998 Hearing for purposes of clarifying the relationship of the various parties now before this Court.

to be used for business purposes.[5] The two loans were current up until the commencement of the case. *See* April 9th Tr. at 42. The Bank asserts a security interest in the Collateral.[6]

It was the testimony of A. Buck that the Debtor had as of April 2, 1999, $41,013.38 in accounts receivables, of which approximately $12,000 are over a year old and, in his opinion, likely to be uncollectible. *See* Bucks' Exhibit 24A and April 9th Tr. at 84. At the time of the April 20, 1999 hearing, A. Buck testified that the Debtor had approximately $27,000 in accounts receivable that were less than 60 days old. He stated that billings to clients were running approximately $25,000 over a two week period or approximately $50,000 per month. According to the Profit and Loss Statement for the month ending February 28, 1999, revenue from services rendered by the Debtor totaled $47,040.32, and expenses totaled $46,803.55. *See* Debtor's Exhibit BB. For the month ending March 31, 1999, revenue amounted to $49,237, and expenses totaled $57,281.21. *See* Bucks' Exhibit 24A.

The Profit and Loss Statement prepared by Benson for the month ending March 31, 1999, differs from that of the Bucks. Based on his review of the Debtor's general ledger, he calculates that revenues actually exceeded expenses by $1,670.76. *See* Benson's Exhibit F. He calculates

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[5] According to Patrillo's testimony, the Bank later advanced monies to the Debtor enabling it to pay off the original loan to Benson, which was guaranteed by the Debtor. This obligation was then consolidated with the other loans made to the Debtor. *See* April 9th Transcript ("Tr.") at 41-45.

[6] On December 13, 1998, the Court signed an Order approving a stipulation pertaining to the use of cash collateral by the Debtor whereby the Bank was granted a rollover lien on the Debtor's postpetition accounts receivables up to $25,000, the amount determined to constitute the accounts receivables as of the petition date. *See* Debtor's Exhibit CC. At the hearing on April 9, 1999, the Court noted that in the event that the case was converted, any testimony would in no way prejudice the rights of a chapter 7 trustee to challenge the validity, priority and extent of the Bank's lien.

revenues of $53,597.92 using a formula whereby he divided the monthly billings for two pay periods by 4 and then multiplied by 4.3 to determine what he described as the actual monthly accrual. He uses the same formula in calculating salaries and wages of $31,778.52 versus A. Buck's figure of $34,841.36.[7]

A. Buck testified that his efforts since the issuance of the November Order have been focused on seeing that the "companions" were paid on a priority basis. He acknowledged that the Debtor had not paid the quarterly fees due the U.S. Trustee[8] and had not made the payments of payroll taxes for February and April amounting to approximately $8,000. He testified further that unemployment taxes for the first quarter of 1999 of $3,500-$4,000 were due and a payment for health insurance of approximately $2,500 was due on April 20, 1999. He also acknowledged that as a result of the Debtor's failure to pay the premium, there was no longer coverage for Worker's Compensation. *See* Bucks' Exhibit 23A. It was A. Buck's testimony that the lack of an ability to pay for Worker's Compensation insurance and the prepetition tax liability in excess

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[7] At the hearing on April 20, 1999, Benson explained that although one would expect his figure to be higher than that of A. Buck's using the formula, A. Buck's figure is actually higher, according to Benson, because it represents salaries and wages for three pay periods. According to the Statement of Cash Receipt and Disbursements for the month ending April 2, 1999, net payroll for three pay periods, namely March 5, 1999, March 19, 1999 and April 2, 1999 actually totaled $41,820.30. *See* Debtor's Exhibit AA. This coincides with testimony that the Debtor's biweekly payroll amounts to between $13,000 and $14,000.

[8] On April 9, 1999, the U.S. Trustee submitted an *ex parte* application requesting that the Debtor's case be converted based on the Debtor's noncompliance with the terms of a conditional order entered on December 22, 1998 ("Conditional Order") which required that the Debtor file monthly operating reports and remain current on the payment of the U.S. Trustee's quarterly fees. As of the hearing on the April 20, 1999, the Debtor had filed the required operating reports.

of $330,000[9] were the main factors which would prevent the Debtor from reorganizing. A. Buck also indicated that the Debtor was in arrears on its payments required in the November Order to C. Buck of $2,458.52 and to A. Buck of $2,217. Benson also had not been paid approximately $9,985.[10]

ARGUMENTS

Debtor's current counsel makes the argument that but for the $10,000 monthly obligation set forth in the November Order, the Debtor would have approximately $7,000 per month to move forward in its operations. He contends that the November Order, approving the parties' stipulation, was not in the best interest of the Debtor and creates an unrealistic obligation on the Debtor.[11] It is his position that the Bucks appear to be unwilling to assist in the Debtor's reorganization efforts and he has serious concerns about alleged self-dealing by Benson which may have occurred prepetition. It is on that basis that the Debtor's counsel requests that the November Order be vacated and an trustee be appointed pursuant to Code § 1104 ("1104

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[9] On February 4, 1999, the Internal Revenue Service filed an amended proof of claim for $323,384.86, which was comprised of a secured claim of $19,317.39, an unsecured priority claim of $250,686.98 and a general unsecured claim of $53,380.40. *See* Bucks' Exhibit 12A.

[10] Under the terms of the November Order, C. Buck and A. Buck each were to be paid $3,000 per month. Benson was to be paid $4,000 per month. A. Buck testified that the Bucks had obtained a restraining order prohibiting the Debtor from paying Benson any monies, thereby accounting for the higher arrears owed to Benson.

[11] At the time the Debtor filed its petition and the November Order approving the Stipulation was signed, the Debtor was represented by Dirk Oudemool, Esq., who also represents Benson and AB Consulting. Pursuant to the Conditional Order, the Debtor was required to retain other counsel. On January 20, 1999, the Court authorized the retention of Edward J. Fintel and Associates to represent the Debtor.

Trustee").

A. Buck contends that there have been no allegations of mismanagement or improper conduct on his or his mother's part that warrants the appointment of an 1104 Trustee to manage the operations of the Debtor. Furthermore, he asserts that a single individual would be unable to perform the duties now handled by himself and C. Buck. He, along with the Bucks, contend that the Debtor has no reasonable likelihood of reorganization and the case should be converted. In this regard, they direct the Court to the operating loss that exists for the first quarter of 1999 of approximately $18,918.80 (*See* Bucks' Exhibit 24A), the fact that the Debtor has been unable to comply with the November Order insofar as it requires payment of $10,000 in salaries, the inability of the Debtor to pay the Worker's Compensation premiums, and the prepetition obligation owed to the taxing authorities of over $330,000.

Benson disputes the Debtor's inability to reorganize. At the hearing in support of his motion seeking to be reinstated in his role as president of the Debtor, Benson proposed what he believes to be cost cutting measures, including (1) elimination of the Debtor's second office in Skaneateles, New York, and the lease of a single office in Syracuse, New York, where most of the Debtor's clients are located, with the idea of decreasing the monthly rent; (2) elimination of A. Buck's position and $3,000 salary, replacing him with a part-time accounting service at an estimated cost of $1,000 per month; (3) elimination of C. Buck's position and $3,000 salary, replacing her with a part-time licensed practical nurse to coordinate the activities and assignments of the companions with his assistance, and (4) elimination of the full-time bookkeeper, replacing her with a payroll service. Benson testified that under his proposal he would assume the administrative and executive duties now shared by A. Buck and C. Buck, including preparation

of the payroll. Benson also testified that the Worker's Compensation premium, prior to cancellation of the insurance on March 19, 1999, had been $21,000 per year based on $435,000-$440,000 per year in companion wages. It was Benson's opinion that the premium could be reduced based on the current annual wages of approximately $300,000.[12]

DISCUSSION

The Court's analysis as a practical matter must begin with a determination of whether the case should be converted. If the Court concludes that conversion is warranted under the circumstances, then any discussion of appointment of an 1104 Trustee becomes unnecessary.

Code § 1112(b) gives the Court discretion to convert a case to chapter 7 for "cause." The determination of whether to convert a case from chapter 11 to chapter 7 involves a question of fact. *See Halvajian v. Bank of New York (In re Halvajian)*, 216 B.R. 502, 511 (D.N.J. 1998), *aff'd* 168 F.3d 478 (3d Cir. 1998). Code § 1112(b) identifies several factors to be considered, but these are illustrative, not exhaustive. *See In re C-TC 9th Avenue Partnership*, 113 F.3d 1304, 1311 n.5 (2d Cir. 1997). Moreover, the ultimate determination is whether conversion would be in the best interest of the creditors. *See In re Schriock Const., Inc.*, 167 B.R. 569, 574 (Bankr.

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[12] While the Court denied Benson's motion, the Court deems it appropriate to consider his proposals in determining whether to appoint an 1104 Trustee or to convert the case. As the Court noted at the April 20, 1999 hearing, "[T]he single factor that will convince this Court to rule on one - grant one motion and deny the other, is whether or not there is any viability to the business. If the Court concludes there is no viability to the business, then it seems to me it can find ample ground under [Code] § 1112(b) to convert the case to chapter 7. Conversely, if the Court finds that there is some viability to the business, the Court believes, at a minimum, that in the best interest of creditors, that there needs to be an 1104 Trustee appointed and would direct the U.S. Trustee to appoint such an individual." *See* April 20th Tr. at 79.

D.N.D. 1994) (noting that once threshold issue of whether "cause" exists is established under Code § 1112(b), the court must ascertain whether dismissal [or conversion] is in the "best interest of creditors of the estate.").

Based on representations made to the Court by the Bucks' counsel, it appears that their motion is one based at least in part on Code § 1112(b)(1). *See* April 9th Tr. at 47. Code § 1112(b)(1) sets forth a two-prong test whereby the Court must first determine whether there has been a continuing loss to or diminution of the estate and then must determine whether there is a lack of reasonable likelihood of rehabilitation. "Full collateralization of assets coupled with a negative cash flow and an inability to pay current expenses has . . . prompted conversion." *In the Matter of 3868 White Plains Road, Inc.*, 28 B.R. 515 (Bankr. S.D.N.Y. 1983). Debtor's primary assets are its accounts receivables, which appear to be fully encumbered by the Bank's security interest. With respect to its cash flow, the Debtor's Profit and Loss Statement for February shows a surplus of $236.77 and for the month ending March 31, 1999, a deficit of $8,044.21. As of March 31, 1999, the year-to-date operating loss totaled $18,918.90. The operating loss for 1998 was $69,811.90. *See* Affidavit of A. Buck, filed March 15, 1999. Of note is the fact that the expenses identified in the Profit and Loss Statements do not include several costs necessary to doing business. For example, the Debtor failed to pay Worker's Compensation premiums of approximately $8,000 over those two months as well as months prior to February 1999, which resulted in the cancellation of its policy in March 1999. A. Buck testified that in order to ensure that the companions were being paid, the Debtor has not paid its withholding tax obligations for February and April 1999 and the quarterly fees due to the office of the U.S. Trustee for the last two quarters of 1998, as well as the first quarter of 1999. In addition, it is in arrears in its

payments due under the terms of the November Order to C. Buck, A. Buck and Benson.

"The concept of rehabilitation necessarily hinges upon establishing a cash flow from which current obligations can be satisfied." *Schriock*, 167 B.R. at 576. In this case, no plan of reorganization has been filed from which the Court might assess the feasibility of the Debtor being able to re-establish itself as an economically viable enterprise capable of servicing its obligations under a plan.[13] The Court heard testimony from Benson in which he suggested several cost-cutting steps to reduce the Debtor's expenses, including consolidating the two offices and eliminating certain personnel. For example, he suggests replacing A. Buck with a part-time accounting service which he estimates will cost approximately $1,000 per month without offering the Court any factual basis for the estimate. He also proposes to replace C. Buck with a part-time licensed practical nurse and to replace the bookkeeper with a payroll service. Again, his figures in this regard are speculative without any factual evidence to support his view that this would result in reducing the Debtor's expenses while maintaining the services necessary for the Debtor to operate and expand its client base. Although under the terms of the November Order, Benson was to develop new business contacts and opportunities for the Debtor, he was unable to account for any new clients as a result of his efforts. Current revenues appear insufficient to satisfy the Debtor's obligations. Based on the Profit and Loss Statements to date and the failure of the Debtor to remain current on its postpetition obligations, it does not appear feasible that the Debtor will be able to re-establish itself. Other than the argument that the elimination of the

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[13] Under the terms of the November Order, Benson was given the responsibility for preparing and filing a plan and disclosure statement. The exclusivity period for filing the plan and disclosure statement lapsed on April 19, 1999, one day prior to the final hearing on these matters, and neither has been filed.

$10,000 in monthly salaries to A. Buck, C. Buck and Benson would allow the Debtor to move forward in its operations, the Debtor has not presented any credible evidence to convince the Court otherwise. q Under these circumstances and based on the evidence before it, the Court concludes that cause exists for converting the Debtor's case to chapter 7. However, the Court's analysis does

not end there. Whether to convert the case depends on a finding that it would be in the best interests of the creditors to do so. Admittedly, the impact conversion may have on the Debtor's employees and clients is, of course, of concern to the Court.[14] However, under the Code it is the interests of creditors which must be given priority. The Bank has received no payments since commencement of the case. The taxing authorities are owed approximately $330,000. Conversion appears to be a more viable alternative. A chapter 7 trustee will be in a position to exercise independent judgment concerning the Debtor, including a determination whether there are any transfers that may be avoided pursuant to Code §§ 544-550 which would result in a recovery on behalf of the estate and its creditors. Conversion is also likely to result in a reduction of administrative expenses.

While the Court has before it a motion by the Debtor for the appointment of an 1104 Trustee, there has been no evidence presented of fraud, dishonesty, incompetence or gross mismanagement post-petition which would warrant such an appointment under Code § 1104(a)(1). Furthermore, the Court finds that the appointment of a trustee under Code §

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[14] A. Buck testified that there are several other agencies in the Syracuse area offering similar services as the Debtor to which the employees and clients could apply for employment and services, respectively.

1104(a)(2) would not serve the interests of the creditors any better than the conversion of the case to a chapter 7. Accordingly, the Court will deny the Debtor's motion.

With respect to the Bank's motion for relief from the automatic stay pursuant to Code § 362(d)(2), the conversion of the case warrants a finding that the Collateral is not necessary for the Debtor's reorganization. It would also appear that there is no equity in the Collateral. However, as the Court noted at Footnote 6, *supra*, the chapter 7 trustee should be afforded an opportunity to challenge the validity, priority and extent of the Bank's lien. Therefore, the Court will conditionally grant the Bank's motion, allowing a chapter 7 trustee appointed herein 60 days from the date of appointment to challenge the validity, priority and extent of the Bank's lien.

Based on the foregoing, it is hereby

ORDERED that the Bucks' motion seeking conversion of the case from chapter 11 to chapter 7 is granted; it is further

ORDERED that the Debtor's motion seeking the appointment of an 1104 Trustee is denied; and it is finally

ORDERED that the Bank's motion seeking relief from the automatic stay is granted on the condition that no challenge to the validity, priority and extent of its lien is filed by a chapter 7 trustee within 60 days of his/her appointment.

Dated at Utica, New York

this 24th day of May 1999

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge